Supreme Court, U.S.
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No. 92 - 621

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1992

DONALD NEAL RAKE, ET AL.,

Petitioners,

v.

WILLIAM J. WADE, TRUSTEE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE TENTH CIRCUIT

REPLY BRIEF OF PETITIONERS

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ARGUMENT

I. BANKRUPTCY CODE SECTION 506(b) DOES NOT REQUIRE THE PAYMENT OF POST-PETITION AND PRE-CONFIRMATION INTEREST ON HOME MORTGAGE ARREARAGES IN CHAPTER 13 BANKRUPTCY PROCEEDINGS

Petitioners contend that in order to cure an arrearage on a home mortgage[1] while in a Chapter 13 bankruptcy, no interest can be paid on such cure payments as a condition precedent to plan confirmation, unless the underlying contract documents provide for such interest. The Respondent and Amicus Curiae, United States, however, both assert that Bankruptcy Code Section 506(b) controls as to the requirement for payment of interest, by virtue of the provisions of Bankruptcy Code Section 103(a).

Petitioners assert that Code Section 506(b) is a statute of general applicability, which must be read in conjunction with the specific provisions of Chapter 13, and when thus read must be found to be controlled by the more specific provisions of Code Section 1322(b)(2). Chapter 5 of the Bankruptcy Code constitutes a part of the general framework for the administration and smooth operation of the various Bankruptcy Code provisions. This general applicability of Chapter 5 promotes Congressional intent of having a unified system of bankruptcy. The title of Chapter 5 (Creditors, Debtors and Estate) is very clearly designed to be of general application in the substantive liquidation and reorganization chapters, Chapters 7, 11, 12 and 13.

Bankruptcy Code Section 506(b) is a statute of general

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[1]Petitioners continue to use the convention established in their brief on the merits, that the term "home mortgage" is used to denote an allowed claim secured solely by a security interest in real property constituting a debtor's principal residence, as set forth in 11 U.S.C. § 1322(b)(2).

application. The Ninth Circuit Court of Appeals, in *In Re Laguna*, 944 F.2d 542, 544 (9th Cir. 1991), in discussing the application of Section 506(b), stated:

> This general right to post-petition interest is statutory and is based neither on the terms of any agreement between the parties nor on the status of the oversecured creditor's claim being either consensual or nonconsensual. *Ron Pair Enters.*, 489 U.S. at 241, 245, 109 S.Ct. at 1030, 1032. Because the provisions of section 506 apply to Chapter 13 proceedings....an oversecured creditor is ordinarily entitled to an allowance for postpetition interest on its secured claim under Chapter 13.
>
> While the above may state the general rule, an oversecured creditor's right to postpetition interest is qualified by, and must be understood in the context of, the interplay that exists between 11 U.S.C. §§ 1322(b) and 1325(a) with respect to modification and cure. (Footnotes omitted.)

With respect to the general rule in the bankruptcy context, Code Section 502(b)(2) disallows interest as a part of a proof of claim, thus stating the general rule in bankruptcy to disallow interest in its entirety. Code Section 506(b), however, modifies this general rule by permitting post-petition interest on oversecured claims. See, *United Savings Association of Texas v. Timbers of Inwood Forests Associates, Ltd.*, 484 U.S. 365, 373, 98 L.Ed.2d 740, 749, 108 S.Ct. 626 (1988).

The United States Court of Appeals for the Third Circuit, in *Wilson v. Commonwealth Mortgage Corporation*, 895 F.2d 123 (3rd Cir. 1990) has construed Code Section 506 to be a section of "general applicability" and controlled by the more specific provisions found in Section 1322(b)(2).

Even if Section 506(b) were held to apply in the present consolidated matters, no reading of that section specifies any particular rate of interest which must be allowed. Petitioners assert that any determination of the amount or rate of interest which must be paid pursuant to Section 506(b) must be exclusively determined pursuant to Bankruptcy Code Section 1322(b)(2), and that this rate must be the bargained for contract amount, both as to maintained payments and arrearage. That is, in the matters before this Court for consolidated review, the parties bargained for two separate and distinct amounts to compensate the Respondent for his loss of use of money: first, the internal interest rate which is not set forth in the underlying documents (J.A. 8, 24) but is admitted by Respondent to exist (Res. Br. 26); and second, a specified amount for late charges, which in the matters consolidated for review before this Court, are one-time charges, unrelated to the length of duration of such delinquent installments (J.A. 8, 22).

By reason of the limitations on Code Section 506(b) by Section 1322(b)(2), which prohibits modification of home mortgage claims in Chapter 13 plans, Congress has established the outer limits of interest which must be paid on home mortgage secured claims in a Chapter 13 proceeding to be that interest provided for in the underlying contract documents.

The Respondent should not be permitted to avoid the natural consequences of his assignor's contracts of adhesion by promoting a misconstruction of Code Section 506(b), as his own contract documents provide for payment in the form of a late charge on delinquencies, which fully compensates the Respondent, in the manner which his assignor selected, for the loss of time value of money on delinquent installments.

II. BANKRUPTCY CODE SECTION 1325(a)(5)(B) DOES NOT REQUIRE POST-CONFIRMATION INTEREST TO BE PAID ON HOME MORTGAGE ARREARAGES

Code Section 1325(a)(5)(B) has been widely held to be the Chapter 13 equivalent of "cram down", a term implying impairment of a claim under Chapter 11 and modification of a claim in Chapter 13. Code Section 1129(a)(7) is the functional equivalent, in a Chapter 11 reorganization, to Code Section 1325(a)(5)(B). Both, in essence, require the secured creditors in these rehabilitation chapters to retain their security interests and be paid in a stream of payments equal to the present value of the secured claim as of the date of confirmation.

The concept of "cram down" in bankruptcy, both in Chapters 11 and 13, contemplates retention of security interests, an impairment or modification of rights of the secured claimant, and a full payment of the allowed secured claim within the limits of the rehabilitation plan term. Code Section 1325(a)(5)(B) specifically requires that the holder of an allowed secured claim retain the lien securing such claim.

Code Section 1129(a)(7)(ii) requires that in order to confirm a Chapter 11 plan involving "cram down", the affected claimant must receive at least an amount equal to or in excess of that which the claimant would have received had the case been administered under Chapter 7 of the Code. By reference to the provisions of Chapter 7 of the Bankruptcy Code, specifically Sections 722 and 724(b), it is clear that the holder of an allowed secured claim in a Chapter 11 "cram down" shall retain his lien, as this would be required in order that the secured Claimant be assured of receiving property of a value, as of the effective date of the plan, that is not less than the amount such holder would have received had the debtor been liquidated under Chapter 7.

The "cram down" provisions of Chapters 11 and 13 are also similar as to the requirement for impairment (Chapter 11) or modification (Chapter 13) of an allowed secured claim. In a Chapter

11 proceeding, the holder of an allowed secured claim can only be "crammed down" under Section 1129(a)(7) if such holder is impaired under the plan, Section 1129(a)(8)(B). If a Chapter 11 secured Claimant is unimpaired, the claimant is conclusively deemed to have accepted the provisions of such Chapter 11 plan of reorganization and is not permitted to cast a ballot on such plan. 11 U.S.C. § 1126(f).

Similarly, in the context of Chapter 13, "cram down" must necessarily follow modification of an allowed secured claim. Code Section 1322(b)(2) permits modification of all secured claims, other than home mortgages. Section 1325(a)(5)(B) requires all holders of allowed secured claims to be paid the present value of such claims, which implies the payment of interest. If any allowed secured claim is not modified in a Chapter 13 plan (whether or not such claim constitutes a home mortgage) the terms of the underlying agreement remain fully in place, including all provisions relating to interest. Thus, all nonmodified secured claims treated in a Chapter 13 plan are paid with interest, as required by Section 1325(a)(5)(B). It is clear, therefore, that Congress intended that modification or "cram down" of a secured claim in Chapter 13 not be permitted unless accompanied by appropriate interest payments. Where the secured claim is not modified, no such protection is needed and Section 1325(a)(5)(B) is not invoked.

Therefore, Section 1325(a)(5)(B) applies only to secured claims which have been modified in the Chapter 13 plan, and which, by reason of Section 1322(b)(2), may not include home mortgages. It should be noted at this juncture that the provisions in Section 1322(b)(5) permitting cure of default on a long term debt, including most home mortgages, does not constitute a prohibited plan modification, but is imposed by the Bankruptcy Code itself.

In a Chapter 13 proceeding, the curing of a default of any claim is effected through one of two provisions found in Section 1322(b), either paragraph 3 or paragraph 5. Both of these provisions

contemplate full reinstatement of contract terms, other than the necessary overlay of the automatic stay applicable to all bankruptcy proceedings, 11 U.S.C. § 362.

In both Sections 1322(b)(3) and 1322(b)(5), the term "cure" is used to indicate the right of Chapter 13 debtors to reinstate underlying contract document terms. The word "cure" in both paragraphs of the same subsection are *in pari materia*. The meaning of "cure" in paragraph 3 of the subsection is best determined by review of paragraph 5 of the same subsection. Section 1322(b)(5) permits the curing of any default within a reasonable time while payments are maintained. Maintenance of payments, in the context of a cure under Section 1322(b)(5), necessarily implies a return to original contract terms. Otherwise, a modified payment could not be maintained -- it would merely be commenced. To maintain payments in a Section 1322(b)(5) cure is to continue with the same payment, under the same rate of interest and the same principal indebtedness as existed on the eve of filing the bankruptcy petition. Section 1322(b)(5) is limited in its application, however, to long term debts, that is, those debts which would not mature in accordance with their document terms until after completion of the Chapter 13 plan. A cure under Section 1322(b)(3), on the other hand, must, of necessity, imply curing short term claims, or those debts which would mature by their underlying terms prior to the termination of the Chapter 13 plan. Otherwise, there is no purpose including the word "cure" in Section 1322(b)(3), and its inclusion is a clear indication of Congressional intent that both short and long term debt defaults may be cured in a Chapter 13 proceeding. However, there is no indication that either cure would be accompanied by any modification of the underlying contract documents.

Since the underlying contract document terms are reinstated in a cure scenario, whether cure is accomplished as a 1322(b)(3) short term debt cure or a 1322(b)(5) long term debt cure, there is no invocation of the provisions of Section 1325(a)(5)(B), as no modification of the underlying contract terms takes place where cure

is invoked under Section 1322(b).

There is an additional reason why a cure under Section 1322(b)(3) would not involve a "cram down" modification as contemplated in Section 1325(a)(5)(B). A modification of a claim under Section 1322(b)(2) does not require cure. If a debt would normally mature by its terms within the term of a Chapter 13 plan, modification of such claim under Section 1322(b)(2) could normally be effected without curing any existing defaults under Section 1322(b)(3), which is a permissive paragraph. Both to modify a claim under Section 1322(b)(2) and simultaneously cure under Section 1322(b)(3) constitutes an additional financial burden to the future income stream devoted to the Chapter 13 plan by the debtors. This additional burden would be borne either by the debtors or their unsecured creditors. Thus, it is never to the advantage of either Chapter 13 debtors or their general unsecured creditors to propose a Section 1322(b)(3) short term debt cure when the same claim could be modified under Section 1322(b)(2).

This clearly points out that cure under Chapter 13 does not equate with "cram down", and the terms are mutually exclusive.

There is, however, a valid purpose for permitting curing of defaults on short term debt in Chapter 13. In those instances in which a home mortgage would fully mature by its terms within the length of a plan term (such as a short term second home mortgage), the prohibition of Section 1322(b)(2) against home mortgage modification would still prohibit "cram down" of such claim. In this instance, a cure of default on short term debt, as permitted in Section 1322(b)(3) could be utilized by Chapter 13 debtors to preserve possessory and title interests in their homestead. Again, Section 1325(a)(5)(B) is not invoked in this scenario, and the contract terms relating to interest, including arrearage interest as calculated by contract document delinquency penalties, are fully reinstated in the Chapter 13 plan.

In its amicus curiae brief, the United States presents a disingenuous argument that the prohibition on home mortgage modifications contained in Section 1322(b)(2) was intended by Congress to prohibit "modification harmful to the creditor" (U.S. Am. Cur. Br. 14). The plain language of Section 1322(b)(2) prohibits "all" modifications to home mortgages, whether the same are detrimental or beneficial to the secured claimant. See, *In Re Stamper*, 84 B.R. 519, 522 (Bkrtcy. N.D.Ill. 1988).

III. THE ISSUE OF BIFURCATION OF A HOME MORTGAGE WAS NOT PRESENTED TO ANY COURT BELOW, AND SHOULD NOT BE CONSIDERED BY THIS COURT ON CERTIORARI

Petitioners were alerted to the attempt by Respondent to expand the scope of this Court's review in the Respondent's Brief in Opposition to Petition for Writ of Certiorari. In it, at page 3, Respondent rails against the perceived inequities of the practice of some Circuits to permit bifurcation of home mortgages in a Chapter 13 context.

Respondent continues his attempt to expand the scope of review before this Court in his brief on the merits, (Res. Br. 23).

The Joint Appendix, setting forth the Chapter 13 plans of the Petitioners verbatim (J.A. 3, 19), clearly demonstrate that no attempt at bifurcation was made in the Bankruptcy Court. Nor was there any attempt to present bifurcation on the part of any party hereto to the Bankruptcy Court, the District Court, or the United States Court of Appeals for the Tenth Circuit. In fact, Petitioners admit that the claims of the Respondent in their respective cases are oversecured, which would absolutely prevent bifurcation under 11 U.S.C. § 506(a). Nonetheless, the Respondent feels compelled to assert that "[w]e recognize this issue [home mortgage bifurcation] is not directly involved in this matter but it is going to be presented sometime in the

future such that comment is apt as a guide to the lower courts", (Res. Br. 23).

This Court, in the recent bankruptcy decision of *Taylor v. Freeland & Kronz*, ____ U.S. ____, _____ L. Ed. 2d _____, 112 S.Ct. 1664, 1649 (1992) stated:

> Our Rule 14.1(a) makes clear that "[o]nly the questions set forth in the Petition [for certiorari] or fairly included therein, will be considered by the Court," and our Rule 24.1(a) states that a Brief on the Merits should not "raise additional questions or change the substance of the questions already presented" in the Petition.
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> ....
>
> In addition, we have said that "[o]rdinarily, this Court does not decide questions not raised or resolved in the lower court[s]." .... These principles help to maintain the integrity of the process of certiorari. .... The Court decides which questions to consider through well-established procedures; allowing the able counsel who argue before us to alter these questions or to devise additional questions at the last minute would thwart this system. We see no "unusual circumstances" that warrant addressing [Respondent's] argument at this time. (Citations omitted)

The Petitioners suggest that, as this Court has granted a writ of certiorari in *Nobelman v. American Savings Bank*, No. 92-641 (December 7, 1992), Respondent would be well-advised to seek leave of this Court to file an amicus curiae brief supporting the position of the Respondent in that matter.

CONCLUSION

There are strong policy reasons favoring the position of the Petitioners. If holders of claims secured by home mortgages feel themselves to be unfairly dealt with in Chapter 13 plans with regard to the length of time proposed for curing arrearages, such Claimants should object to those plans as not curing the defaults within a reasonable time. The Bankruptcy Court is in the best of all possible positions, on a case by case basis, to balance the competing interests of home mortgagees and other parties in interest, principally debtors and holders of unsecured claims, regarding what would constitute a reasonable time to effect cure in a Chapter 13 plan. The nature of the bankruptcy system is such as to constantly seek a balancing of the competing equities utilizing the scarce resources of debtors in rehabilitation Chapters. The framework established by Congress in Chapter 13 is clear and the plain meaning of all relevant statutes may be harmonized by denying interests incident to the cure of a home mortgage arrearage in a Chapter 13 plan, where the underlying contract documents fail to provide for a continuing rate of interest on delinquent installments until paid.

The decision of the United States Court of Appeals for the Tenth Circuit resulting in this review should be reversed.

Respectfully submitted,

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